PART 9

What Will Globalization Bring?

Chapter 35

Globalization, Trade Reform, and the Developing Countries

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Globalization, particularly trade expansion and capital flows, offers new opportunities but also raises new challenges for developing countries.

Since the first round of trade negotiations under the General Agreement on Tariffs and Trade (GATT) after World War II, multilateral trade liberalization has progressed at a fairly steady pace, mostly among the developed countries. But the Millennium Round of trade negotiations, if it proceeds, will look somewhat different. Of the 134 members of the World Trade Organization (WTO) in February 1999, some 70 percent are developing countries. This growing developing-country involvement in the WTO, as well as in regional trading blocs and other trade arrangements, represents a distinct break with the past.

While there were relatively few developing-country members of GATT, they did take a more active role in the Uruguay Round of negotiations (which were completed in 1993) than they had in earlier rounds. This round saw some substantive progress toward adoption of issues of importance to developing countries. One such area was agriculture, where the Uruguay Round established a new framework for international trade rules encompassing export subsidies, domestic subsidies, and market access, while related agreements covered other issues of importance for agricultural production such as sanitary and phytosanitary measures.

Still, recognizing that the new rules agreed upon were only the beginning of the reform process, the participating countries decided to resume the negotiations in the year 1999. Therefore, with or without a Millennium Round, agricultural negotiations will recommence sometime at the end of this year.

This essay looks at the evolution of agricultural markets leading to the Uruguay Round negotiations and places them in the context of an increasingly global world economy, focusing on developing countries. The essay then considers, also from the perspective of the developing countries, several issues that are likely to arise in the coming negotiations.

Moving toward a Global Economy

The Forces of Globalization

Globalization refers mainly to the recent trends toward stronger economic, political, and cultural ties among many of the world's nations. One of its most important manifestations is the expansion of international trade, but it also encompasses increased international flows of capital, technology, and labor around the world, along with tendencies toward universal application of some institutional, legal, political, and cultural practices.

Within that context, some developing countries have had a strong growth performance, while others have fallen behind, both relative to other countries and, in some unfortunate cases, in absolute terms. Increased participation by countries in global markets has also been uneven. The expansion of trade has been driven by a number of forces that have affected developed and developing countries in different ways. An important factor has been the progressive dismantling of trade barriers for goods and services between countries through both successive rounds of GATT negotiations and unilateral liberalization in many countries.

A separate influence has been rapid technological change. Investment in transportation, communications, and information processing systems has skyrocketed. Major changes in production technology in many sectors, combined with improved transportation and communications, have allowed producers to separate stages of the production process geographically, sending raw materials far away from where they are grown to be processed and packaged. Producers can also pursue economies of scale and specialize by making large quantities of a single item to be sold throughout the world. Within manufacturing, the process of specialization has accelerated trade in the components that go into finished products. While these trends have been most evident in developed countries, a number of semi-industrial countries have participated and benefited from growth based on increased trade in manufactures. The early pioneers, such as the Asian "gang of four" (Hong Kong, Korea, Singapore, and Taiwan), achieved spectacular growth during the 1970s and 1980s. Following the lead of the Asian countries, many developing countries have shifted from inward-looking to outward-oriented development strategies, deepening their links to world markets.

Yet globalization involves more than just commodity markets. Increasing integration of world capital markets has greatly expanded international flows of both short-term and long-term private financial capital, with important effects on investment and growth. However, the poorest countries, with undeveloped capital markets and high risk premiums, have largely been left out of this growing international financial market. Also, some countries, as a consequence of global economic developments beyond their control as well as inappropriate domestic policies, have faced damaging episodes of macroeconomic instability, requiring "structural adjustment" to restore growth and stability.

Globalization of world financial markets has also led to problems. The recent Asian financial crisis revealed weaknesses in both the international financial system and the financial systems of a number of developing countries. Many developing countries are simply unable to absorb or efficiently manage the kinds of large short-term capital flows that have become more common.

Globalization, particularly trade expansion and capital flows, offers new opportunities but also raises new challenges for developing countries. As they approach the Millennium Round, these countries should evaluate their current development strategies and domestic macroeconomic policies, as well as their stance at the negotiating table, in order to gain the greatest benefits from the new global economy.

Changing Agricultural Markets

In addition to the obvious influences of population, weather, and wars, growth in world agricultural production and trade in the postwar era has been affected by changes in three main areas: macroeconomic policies, trade and agricultural policies, and technology.

At the macroeconomic level, expansionary monetary and fiscal policies during the 1960s and 1970s led to faster economic growth, but also eventually to higher inflation and negative real interest rates, which hurt growth. The macroeconomic environment changed radically during the 1980s, when tight monetary policies lowered real growth and inflation rates and turned real interest rates strongly positive for the entire decade. By the second half of the 1990s, inflation had fallen to levels similar to the 1960s. What has been labeled the "rise and fall of inflation" had an important impact on agriculture. In the 1970s high real commodity prices combined with negative real interest rates led farmers to expand their productive capacity, but prices fell steeply in the 1980s when macroeconomic policies were changed and farmers faced weak demand for their expanded supplies of agricultural goods.

Second, trade and agricultural policies in different countries and regions have gone through dramatic changes in recent decades. The Soviet Union went from being an important component of world demand in agricultural markets since the mid-1970s to collapsing as a political entity by the end of the 1980s. China sizably increased its agricultural production thanks to sweeping policy changes instituted at the end of the 1970s that emphasized decentralization and price incentives for farmers. The European Union (EU), driven by large production and export subsidies under the Common Agricultural Policy (CAP), moved from being a net importer of grains, meat, and sugar in the 1960s and 1970s to becoming a net exporter. Also, the United States pursued farm support policies that led to large surpluses in production and increased exports, some of which were sold with subsidies in world markets starting in the mid-1980s.

A variety of developing and emerging economies have shifted from inward-oriented development strategies in the 1960s and 1970s to greater reliance on free markets and international trade, particularly since the late 1980s. These new strategies have led policymakers to undertake major domestic agricultural policy reforms. In the past, IFPRI research found that a combination of overvalued exchange rates, protection of domestic industry, and explicit taxation of agricultural exports led to economic biases against agriculture, especially in very poor countries in Africa. After the policy changes of recent years, research at IFPRI and elsewhere suggests that such reforms have greatly reduced and in some cases eliminated the bias against agriculture in many developing countries. Although further improvements in domestic trade and macroeconomic policies are still needed in various developing countries, the reforms already undertaken provide a better framework for traditional investment policies and projects in the agricultural sector, focusing on human capital, land, water, property rights, management, technology, and infrastructure. These agricultural policies had been largely abandoned during the period when redirection of the overall macroeconomic and trade framework appeared central.

Third, changes in agricultural technology, such as mechanization, use of chemicals, and improvements in biology, have been continuous, as the Green Revolution emerged and spread in developing countries. The development of new seeds and more recent advances in genetic engineering have already provided dramatic productivity increases and will likely be the basis for continuing growth in the next century. Likewise, existing technologies disseminated from the developed to the developing countries provide a major impetus to their agricultural growth and are expected to do so for some time.

All in all, these macroeconomic, trade, and technological factors contributed to a phase of high growth in world agricultural production during the 1970s and later to a period of weaker demand and growth in the 1980s and early 1990s. By the end of the 1980s, the high and rising fiscal costs of the EU and U.S. policies were becoming politically unsupportable. These policies also led to instability in world markets, causing concern among other agricultural producers. For a few developed countries with large agricultural sectors (such as Australia, Canada, and New Zealand) and for a few developing countries (such as Argentina, Brazil, and

Thailand), agricultural exports have always been extremely important. The major agricultural exporters outside the European Union and the United States organized themselves into a negotiating bloc called the Cairns Group, which effectively represented their interests in the Uruguay Round negotiations. After much effort, the combination of concerns about distorted world markets, fiscal constraints in the United States and the European Union, and diplomatic pressure from agricultural exporting countries, led to the successful conclusion of the Uruguay Round negotiations in 1994. The result was probably less reform than was hoped for when the negotiations began but more than was expected by the end. There is still much to do.

Agricultural producers in all countries now operate in less distorted domestic and international environments where they are subject to more market discipline and where international trade plays a greater role. Policymakers must adjust their domestic policies to the new conditions and have a stake in shaping that environment through trade negotiations. This is particularly important for developing countries that have already made significant domestic policy changes but still have to contend with developed-country agricultural policies that have negative welfare effects for the whole world.

Getting Ready for New Trade Negotiations

Bringing agricultural policies under international scrutiny was an important accomplishment of the Uruguay Round, but the reform process has not finished. Agricultural negotiations, alone or as part of a new round, will resume during 1999.

The world economy and the trade policy environment have changed substantially since the completion of the Uruguay Round negotiations. The European Union is expanding its membership and is considering further reforms to its Common Agricultural Policy to accommodate new members. The North American Free Trade Agreement (NAFTA) and the Southern Cone Common Market (MERCOSUR) are up and running, and regional institutions such as the Asia-Pacific Economic Cooperation (APEC) forum and the Free Trade Area of the Americas (FTAA), which were embryonic at the time of the Uruguay Round, have become more prominent. Subregional trade agreements in Africa, Asia, and Latin America are expanding and consolidating.

New problems have also appeared. Asia, the largest source of net demand for world agricultural products, has seen income and demand fall, as the countries cut their trade deficits in the wake of the Asian financial crisis. Partly resulting from that crisis, the U.S. trade deficit has already started to increase dramatically, leading to renewed protectionist pressures. Low world agricultural prices and fiscal surpluses have led to increased demands to abandon the market-oriented reforms of the

1995 Farm Bill. President Clinton has yet to secure "fast-track" negotiating authority, considered necessary for serious trade negotiations. In Europe recent changes in agricultural policy do not appear enough to restrain growing agricultural surpluses that hurt agricultural producers in other countries.

The international financial crisis points to the complexity of international financial transactions and could pose a long-run threat to greater market openness. Therefore, coordinating macroeconomic policies and designing more resilient international financial architecture may be at least as important as WTO negotiations for expanding international trade.

Completing the Unfinished Agenda of the Uruguay Round

While many developing countries have significantly reduced distortionary domestic agricultural policies, the benefits these countries and the world can enjoy are thwarted by the subsidies of developed countries. In future negotiations developing countries should seek to eliminate developed-country export subsidies, strengthen surveillance of state trading enterprises, and establish an integrated framework for food aid and export credits. As for domestic subsidies, developing countries should seek further limits on developed countries' trade-distorting payments to farmers. Least developed and developing countries are allowed "special and differential" treatment on these issues, which is desirable if they use their flexibility wisely, smoothing rather than fighting needed adjustment and structural change.

If the developing countries are to succeed in diversifying their agricultural sectors, they must have expanded access to markets in developed countries. The developed countries must increase the volume of imports allowed under the current regime of tariffs and quotas, make the administration of tariffs and quotas more transparent and equitable, further reduce high tariffs on some key products, and complete the process of tariffication where exemptions were granted. Also, eliminating or at least reducing tariff escalation in nonagricultural products is important for developing countries. Rising tariffs undermine the production and export of processed goods that use agricultural inputs.

Considering the Needs of the Most Vulnerable

Upon completion of the Uruguay Round, participating trade ministers agreed on a declaration recognizing the special concerns of the least-developed and net-food-importing countries. These concerns include the preservation of adequate food aid, the provision of technical assistance and financial support to develop agriculture in those countries, and the expansion of financial facilities to help with structural adjustment and short-term difficulties in financing food imports. If prices in world markets become more volatile or if agricultural policies in the developed countries are not further reformed, these poorer countries may lose secure access to food supplies at reasonable prices. Because world grain stocks have been declining as a share of consumption, officials must monitor volatility in agricultural prices carefully. Negotiating countries should also work on improving mechanisms to give early warning of potential food shortages, lowering food transportation and storage costs, and providing better-targeted food aid programs and financial facilities for emergencies.

The impact of changes in trade and agricultural policy on poorer consumers and producers is a matter of debate. Certainly the goals of development and poverty alleviation will not be served by trade-distorting interventions that operate as taxes on food consumers (with the greater burden falling on the poor) or by subsidies that allocate scarce fiscal revenues to wasteful programs. Under the agreements reached in the Uruguay Round, unfair competition that hurts poor farmers, such as subsidized (or dumped) agricultural exports, are being disciplined. At the same time, the agreement allows developing countries to continue most agricultural and social policies linked to poverty alleviation and agricultural development.

Other Trade-Related Issues

Genetically modified agricultural products present a special challenge. The public may block the development of important new technologies to feed the world in coming decades if policymakers do not handle the issues surrounding genetically altered food sensitively, particularly through rigorous analysis of the risks to human health and biodiversity.

Debates over links between trade, labor, and the environment will continue to require scrutiny of the different claims regarding the impact of low wages and environmental standards on agricultural trade.

New WTO Members

Although the issue of WTO accession of new members is not part of the upcoming agricultural negotiations—those discussions proceed on different tracks—the way it is handled can have important consequences for world agricultural markets. Particularly important is China, the world's largest agricultural producer, representing about 20 percent of world production. The list of eventual members of WTO also includes countries such as Russia, Taiwan, Ukraine, and Viet Nam, all important players on both the supply and demand sides of world agricultural markets.

The Political Economy of Trade Negotiations

During the Uruguay Round agriculture was part of a wider negotiation that allowed negotiators to consider trade-offs between agricultural and nonagricultural interest groups within countries. The United States and the European Union were under pressure to reduce the fiscal cost of agricultural support; world agricultural markets were badly distorted; and the U.S.-EU subsidy war was disrupting world markets. Now negotiators face different issues. The fiscal position of the United States has improved significantly, and the European Union has reduced its fiscal deficits, although the cost of EU support for agriculture remains high. Some of the distortions in world agricultural markets have been reduced, and export subsidies for several products have declined below the levels required by the Uruguay Round agreement. Also, if the negotiations on agriculture are conducted apart from other issues, the leverage of countries interested in further reforms will be reduced. In any case, as in the past, the new WTO agricultural negotiations may well be defined by the pace and shape of the reform of the EU's Common Agricultural Policy, currently under discussion.

The Role of Developing Countries in New Trade Talks

Results from the IMPACT global projection model developed at IFPRI show that past trends in agricultural growth will continue into the next century, with world trade in agricultural goods becoming more important. The projections also indicate that countries that pursue comparative advantage will benefit from increasing specialization in agricultural production. In that context, developing countries, as small players in the global arena, should be active participants in designing and implementing international rules that limit larger countries' ability to resort to power politics and unilateral action. Developing countries may overcome some of the constraints to participation by resorting to collective action. For instance, they could consider creating alliances based on shared policy concerns, like the Cairns Group. This approach could reduce the fixed costs of negotiations by spreading them over groups of countries, allow better use of scarce technical expertise, and improve their bargaining position.

It is clearly in the interest of the developing countries to be active and informed participants in general trade and financial talks, as well as in agricultural trade negotiations. IFPRI's research on global trade and macroeconomic issues will continue to produce data and policy analysis to try to clarify the different commercial and financial scenarios and analyze their likely effects on developing nations, looking particularly at low-income countries and the poorer producers and consumers within them. In the final analysis, the developing countries as a group have much to gain from continued progress toward a transparent, rule-based trading system in agriculture as an integral part of a more solid and balanced world trade and financial system.